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October 17, 2005

Allen C. Lloyd, Ph.D., Agency Secretary
California Environmental Protection Agency
1001 I Street
Post Office Box 2815
Sacramento, California 95812-2815

RE: **Comments on Draft Implementation Options, Table 3**

Dear Secretary Lloyd:

On behalf of Calpine Corporation, I want to thank you for the opportunity to comment on the draft of implementation options that were developed in September and will be discussed initially during tomorrow's meeting of the Climate Action Team.

As you know, Calpine supports the climate change goals announced by Governor Schwarzenegger on June 6, 2005 and we look forward to working with you and others in the Administration to help craft policies to achieve these goals. Generally speaking, our guiding principal in supporting any policy is that it must apply equally to old, new and in-state and out of state generation.

As it begins to work on implementation policies, the Climate Action Team has requested that stakeholders respond to a list of emission reduction options prior to the October 18 meeting. Below are Calpine's comments on these and other options we believe the Team should consider:

## I. Reject Any Climate Policies Modeled Upon the Oregon/ Washington Climate Trust.

In both the Washington and Oregon climate programs, only new and in-state power sources are subject to carbon mitigation rules, which require these sources to pay what is essentially a carbon tax prior to developing new generating facilities. Such policies are counterproductive because they send exactly the opposite signals that are needed to help move California to a lower carbon future. That is because they penalize newer generation, which is usually dramatically cleaner and emits much lower carbon dioxide ($CO_2$) than older power sources. Instead, these policies provide a huge competitive advantage to older and higher emitting generation both within California and located outside the state. Calpine will strongly oppose any climate change plan that is modeled on these two programs as it does not conform with our guiding principal of equity.

To the contrary, one of the most immediate steps California can take to reduce carbon emissions from the electric power sector is to expedite the transition from old, high carbon intensive power generation and replace these polluting sources with new, efficient combined cycle natural gas plants and more renewable power. Calpine believes that policies such as those adopted in Washington and Oregon will hinder such progress, leading not just to higher $CO_2$ emissions, but higher conventional pollutants then would otherwise occur with more forward looking policies. Because Calpine feels that these two models are counter productive to achieving the Governor's climate reduction goals, we urge the Climate Action Team to remove this option from any further consideration.

## II. Support Power Plant Procurement Policies that Include Imported Power and Encourages Low and Zero Carbon Generation.

While not listed among the options, a second important steps in meeting the Governor's goals is to ensure that California does not reduce its greenhouse gas emissions by exporting its carbon dioxide and other pollutants to places outside the state. This is particularly important in the electric power sector, where imported power is already a major source of California's carbon dioxide emissions, totaling 67 million tons annually. The state has already started to signal that in its future procurement of power, it will encourage low carbon generation and renewable energy sources.

For example, the California Public Utility Commission (CPUC) has taken steps in this direction through the adoption of a "carbon adder" when the state's load serving entities (LSE) procure future power for their California customers. Calpine particularly supports another approach recommended by the California Energy Commission (CEC) as part of its draft 2005 Integrated Energy Policy Report (IEPR). In its proposal, the CEC recommends that any future baseload power that is procured for consumption in California, both in-state and out-of-state, adopt a carbon emission performance standard that is equal to or lower than that achieved by today's modern combined cycle power generation. Calpine believes that both of these approaches help demonstrate that California is committed to lowering its carbon profile within the electric power sector.

Calpine believes that any performance standard should be adopted without any offset provisions, since such offsets could severely undermine the effectiveness of the standard. Instead, carbon offsets should be considered in the contexts of a future cap and trade program, such as currently under review by the California Environmental Protection Agency.

## III. Future Cap and Trade Programs Must Encourage the State's Power Sector to Move Toward Low and Zero-Carbon Emitting Technologies.

In general, Calpine supports efforts to use cap and trade programs as one of the most cost effective ways to reduce carbon emissions throughout the economy. Specifically, we have supported the Clean Air Planning Act, federal legislation that would establish a national cap and trade program for carbon emissions within the power sector. In general, Calpine believes that a national or regional program is preferable to a California-only program, since robust carbon trading requires a wide array of participants. Calpine also believes that while a seemingly technical issue, one of the most important policy designs associated with establishing a successful trading program will emission allocation. Calpine believes that such an allocation program should encourage efficiency and reward low and zero-emitting technologies. It should also support technologies that provide environmental 'co-benefits' beyond just reducing $CO_2$. Finally, allocation should not become a "backdoor" carbon tax that establishes massive new revenue raising vehicle and the associated new state bureaucracies.

Calpine recommends that the Climate Action Team adopt the following principles associated with the design of allowance allocation in the context of a future cap and trade program:

The goal of allocation mechanisms should be to provide a significant measure of regulatory certainty for the affected parties and the public. In light of the long-lived nature of investments in the power sector, the overall program structure and mechanics should be set out in advance for a multi-year program.

ii. The number of emissions allowances allocated to the power sector should be periodically updated ("updating allocation"). This is opposed to a one-time allocation approach ("historic allocation"), which freezes the pattern of distribution of allowances *in perpetuity*. An updating allocation better allows for incorporating new (and usually lower-carbon) generating sources and better reflects technology advancement and accommodates changes in the location of electric production and use over time. Such updating should take place every 2-4 years.

iii. Allocation of allowances to owners of power plants should be based upon electrical output (i.e. in megawatt-hours (MWh)) in order to encourage efficient generation of electricity from fossil fuels and to allow for the possible inclusion of renewable generating sources.

iv. Technologies that reduce carbon emissions from coal.

Again, we appreciate the opportunity to provide you and others on the Climate Action Team with our initial thoughts regarding the various policy options available to California as it addresses this historic challenge.

Sincerely,

**CALPINE CORPORATION**

**KASSANDRA F. GOUGH**
**DIRECTOR, GOVERNMENT & LEGISLATIVE AFFAIRS**

cc: Climate Action Team Members